

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
N. Lee Lacy Associates Ltd. :
for Redetermination of a Deficiency or a Revision :
of a Determination or a Refund of Corporation :
Franchise Tax under Article 9A of the Tax Law for :
the Year Ending 3/31/76. :
_____ :

AFFIDAVIT OF MAILING

State of New York
County of Albany


Connie Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, over 18 years of age, and that on the 21st day of October, 1983, she served the within notice of Decision by certified mail upon N. Lee Lacy Associates Ltd., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

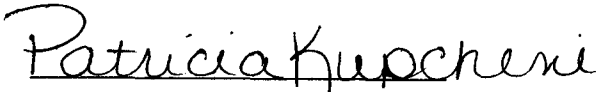
N. Lee Lacy Associates Ltd.
160 E. 61st St.
New York, NY 10021

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
21st day of October, 1983.





AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

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In the Matter of the Petition :
of :
N. Lee Lacy Associates Ltd. :
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AFFIDAVIT OF MAILING

State of New York
County of Albany

Connie Hagelund, being duly sworn, deposes and says that she is an employee of the State Tax Commission, over 18 years of age, and that on the 21st day of October, 1983, she served the within notice of Decision by certified mail upon Clifford Wasserman the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

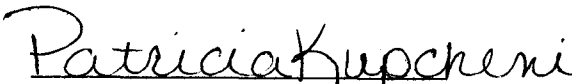
Clifford Wasserman
Kaniuk, Malakoff & Wasserman, CPA, P.C.
98 Cutter Mill Rd.
Great Neck, NY 11021

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
21st day of October, 1983.




AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

October 21, 1983

N. Lee Lacy Associates Ltd.
160 E. 61st St.
New York, NY 10021

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9 State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Clifford Wasserman
Kaniuk, Malakoff & Wasserman, CPA, P.C.
98 Cutter Mill Rd.
Great Neck, NY 11021
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
N. LEE LACY/ASSOCIATES, LTD.
for Redetermination of a Deficiency or for
Refund of Corporation Franchise Tax under
Article 9-A of the Tax Law for the Year
Ended March 31, 1976.

DECISION

Petitioner, N. Lee Lacy/Associates, Ltd., 160 East 61st Street, New York, New York 10021, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the year ended March 31, 1976 (File No. 31518).

A formal hearing was held before Daniel J. Ranalli, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on December 1, 1982 at 3:00 P.M. with all briefs to be submitted by March 22, 1983. Petitioner appeared by Kaniuk, Malakoff & Wasserman, (Clifford Wasserman, Esq., of counsel). The Audit Division appeared by Paul B. Coburn, Esq. (Michael Gitter, Esq., of counsel).

ISSUE

Whether the Audit Division properly disallowed a deduction for a foreign exchange loss incurred by petitioner in transactions with related corporations.

FINDINGS OF FACT

1. On August 15, 1980, as the result of a field audit, the Audit Division issued a Notice of Deficiency pursuant to Article 9-A of the Tax Law against petitioner, N. Lee Lacy/Associates, Ltd., in the amount of \$3,575.00 plus interest of \$1,190.17 for a total due of \$4,765.17 for the fiscal year ended

March 31, 1976. The deficiency resulted from the disallowance, by the Audit Division, of a \$39,600.00 deduction for a foreign exchange loss incurred by petitioner in transactions with related corporations.

2. Petitioner is one of a group of corporations owned by N. Lee Lacy and Benson Green. During the year in issue, the active corporations owned by Messrs. Lacy and Green, in addition to petitioner, were N. Lee Lacy/Associates, Ltd., Los Angeles ("Lacy LA"), N. Lee Lacy/Associates International, Ltd. ("Lacy International"), and N. Lee Lacy/Associates, Ltd., United Kingdom ("Lacy UK").

3. Petitioner and Lacy LA are television commercial production companies. Each company has its own staff and performs identical functions. Petitioner produces commercials on the east coast and Lacy LA produces on the west coast. Lacy International was organized in Lichtenstein to make commercials in Europe. Lacy International retains third parties to direct and produce commercials. Lacy International's books and records are maintained in Lichtenstein. Lacy UK produces commercials in the United Kingdom. It has its own staff and bills its clients directly.

4. During the years prior to and including the year in issue, Lacy International lent Swiss francs to petitioner. These loans bore interest of approximately 5.5 percent and were made over a period of years. Prior to March 31, 1976, as a result of said loans, petitioner owed Lacy International the principal amount of \$349,033.00 plus interest of \$65,904 for a total of \$414,937.00. The principal amount represented the U.S. dollar equivalent of the Swiss franc on the dates that each of the loans were made. In addition, the cumulative exchange rate difference between the U.S. dollar and the Swiss franc as applied to the total Swiss francs owed as of March 31, 1976, and the

U.S. dollar equivalent of the Swiss francs loaned at the time the various loans were made amounted to \$74,729.00. For accounting purposes, each year's fluctuation was recorded as income or expense on the books of the two companies.

5. During the aforesaid years, petitioner lent U.S. dollars to Lacy UK. As of March 31, 1976, Lacy UK owed petitioner \$280,689.00. On March 31, 1976, petitioner transferred to Lacy International \$225,000.00 of principal debt owed petitioner by Lacy UK. Based on exchange rate differences, the \$225,000.00 transfer was in satisfaction of only \$185,400.00 of principal debt due Lacy International. For accounting purposes, the transfer resulted in no devaluation expense or income being recorded on the books of either company, as such items had been previously recorded each year as they accrued. For tax purposes, however, since the devaluation expense accrued prior to the transfer had not been deducted by petitioner because no "payment" had been made, it deducted \$39,600.00 of devaluation expense (the difference between the \$225,000.00 receivable from Lacy UK and the \$185,400.00 payable to Lacy International, which amount was retired) on its return for the fiscal year ended March 31, 1976, as that was the year of the transfer.

6. The books and records of petitioner, Lacy UK, and Lacy International reflected the March 31, 1976 transaction as follows: petitioner debited due to Lacy International \$225,000.00 and credited due from Lacy UK \$225,000.00. Lacy International debited due from Lacy UK \$225,000.00 and credited due from petitioner \$225,000.00. No accounting entry was made by either company for the devaluation adjustment as such devaluation expense (in the case of petitioner) or income (in the case of Lacy International) had been reflected on an annual basis in the years they accrued. Lacy UK debited due to petitioner for \$225,000.00 and credited due to Lacy International \$225,000.00.

7. Petitioner argued that the aforesaid loans were arm's length transactions which were closed and completed during fiscal year ended March 31, 1976 and that the resulting devaluation loss was deductible under section 165(a) of the Internal Revenue Code. Petitioner maintained that the fact that the three corporations involved were all owned by the same two persons is not, in itself, sufficient to establish that the transfers were not in furtherance of a real and valid business purpose. The Audit Division argued, inter alia, that the loans were mere sham transactions entered into for tax-saving purposes only and not for any valid business reasons.

CONCLUSIONS OF LAW

A. That subdivision 9 of section 208 of the Tax Law provides, in part, that "[t]he term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department...". Except as provided in New York statutes, net income must be calculated in accordance with the definitions and dictates of the Internal Revenue Code (Conway, Co. v. Lynch, 258 N.Y. 245).

B. That section 165(a) of the Internal Revenue Code allows as a deduction "any loss sustained during the taxable year and not compensated for by insurance or otherwise". Section 1.165-1(b) of the Treasury Regulations provides, in part, that "[t]o be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events...actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss".

C. That the transaction from which the loss is derived "must have been motivated by a 'business purpose' before the loss can be accepted as substantive and bona fide" (Northern Pacific Ry. Co. v. United States, 378 F. 2d 686, 691 [Ct. Cl. 1967]). The concept of a business purpose "was developed primarily to assure that a transaction sought to be recognized for tax purposes would have some substantial basis other than a hoped-for tax saving. But it is not every non-tax use of a subsidiary (or related corporation) which can properly be called a 'business purpose'" (id. at 692).

D. That, assuming without deciding, that petitioner's loan transactions were arm's length transactions which were closed and completed during the year in issue, petitioner failed to show that any valid business reasons underlay the loans. Lacy International could have, as easily, made loans directly to Lacy UK without having to go through petitioner and without a resulting devaluation loss. Petitioner failed to show that there were any other objectives of the loans other than to attribute the loss and corresponding deduction to it so that petitioner could obtain the tax benefit. Without further evidence, the Audit Division properly disallowed petitioner's claim for a deduction based on a devaluation loss.

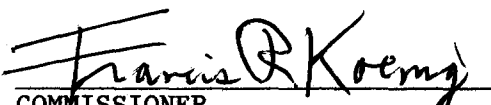
E. That the petition of N. Lee Lacy/Associates, Ltd. is denied and the Notice of Deficiency issued August 15, 1980 is sustained.


DATED: Albany, New York

STATE TAX COMMISSION

OCT 21 1983


PRESIDENT


COMMISSIONER


COMMISSIONER